1136. But the *FNPRM* goes well beyond that: it suggests a number of alternate rationales that have nothing to do with foreclosure. *See FNPRM* ¶¶ 27-45.

Even if this approach is not squarely precluded by the court of appeals' decision, *see Time Warner II*, 240 F.3d at 1133, the *FNPRM*'s approach is ill-advised. This Commission has had two previous opportunities to formulate a justification for a subscriber limit. The *Third Report* — issued after *three* rounds of comments and after litigation that crystallized the most pressing objections to the Commission's approach — presumably reflected the Commission's best thinking on the issue. That report sought to tie the subscriber limit to a single perceived problem: foreclosure. It is simply not credible that, despite the Commission's long history of studying the issue, it should now discover an entirely new justification. It is even less credible that this previously undiscovered problem should happen to justify the same 30-percent cap previously adopted. It is unlikely that either of these results could withstand judicial review.

In any event, if the Commission were to attempt to predicate a subscriber limit on one of the new "problems" to which the *FNPRM* points, the result would still have to pass muster under intermediate First Amendment scrutiny. As illustrated by *Time Warner II*, intermediate scrutiny is considerably more demanding than standard review under the Administrative Procedure Act (which any subscriber limit of course must also pass). To survive intermediate scrutiny, a rule must "furthe[r] an important or substantial governmental interest" and may not impose a burden that is "greater than is essential to the furtherance of that interest." *Turner I*, 512 U.S. at 662 (internal quotation marks omitted). It is not enough that the FCC "simply posit the existence of the disease sought to be cured." *Id.* at 664 (plurality) (internal quotation marks omitted). Rather, the FCC "must demonstrate that the recited harms are real, not merely conjectural, and that the regulation will in fact alleviate these harms in a direct and material way." *Id.* That showing must be "based on substantial evidence." *Id.* at 666 (plurality); *see Time Warner II*, 240 F.3d at 1133. Here, this showing cannot possibly be made.

1. The *FNPRM* Is Wrong in Suggesting That a Subscriber Limit May Be Needed To Safeguard Competing MVPDs' Access to Programming.

Whereas the Commission's foreclosure theory is aimed at protecting video-programming services, the *FNPRM* also points to a theory whose aim is to protect overbuilders and other competitors to cable operators. *See FNPRM* ¶¶ 29-30. Here, the posited problem is that large MSOs may receive discounts from video-programming services, which may make it difficult for competitors not receiving such discounts to compete. *See id.* ¶ 29; *see also id.* ¶¶ 34, 37-39, 43. The Commission seeks comment on whether these concerns justify a subscriber limit.[37]

The answer is no. There is no evidence that, to the extent large MVPDs receive discounts, those discounts reflect the unfair exercise of market power (as opposed to legitimate efficiencies). As already explained, *see supra*, pp. 18-19, larger MVPDs can provide video-programming services with efficiencies in the form of lower transaction costs and lowered risk.

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[37]The *FNPRM* also suggests that, if MSOs are permitted to become too large, they may be able to convince video-programming services to sign exclusive agreements "not covered by program access rules." *FNPRM* ¶ 30. That supposed problem is simply a red herring. It is entirely unclear why larger MSOs would be more likely to enter into exclusive agreements than smaller MSOs. Besides, many exclusive agreements are specifically outlawed by the program-access rules. *See* 47 C.F.R. § 76.1002(c). Other exclusive agreements are subject to other constraints. *See id.* §§ 76.1001, 76.1301(b). If exclusive agreements posed a non-conjectural problem (which has not been shown), the obvious solution would be to fine-tune the rules applicable to exclusive agreements. *See Implementation of the Cable Television Consumer Protection and Competition Act of 1992; Development of Competition and Diversity in Video Programming Distribution: Section 628(c)(5) of the Communications Act: Sunset of Exclusive Contract Prohibition*, CS Docket No. 01-290, FCC 01-307 (rel. Oct. 18, 2001).

Because these efficiencies lower video-programming services' costs, they naturally translate into lower license fees. *See* Joskow & McLaughlin 16. And taking advantage of legitimate efficiencies is simply not "unfair[]," 47 U.S.C. § 533(f)(2)(A), and therefore cannot be the basis for a subscriber limit, *see Time Warner II*, 240 F.3d at 1135-36 & n.6 ("[T]he statute allows for regulation only if unfairness can be shown.").

That discounts reflect efficiencies is borne out by their incidence in the face of competition at the MVPD retail level. As already explained above, "competition raises the stakes for a firm that sacrifices the optimal price-quality trade-off in its acquisition of programming." *Time Warner II*, 240 F.3d at 1139. In a competitive environment, any video-programming service negotiating a new license agreement can make the ultimate threat: "Unless you pay a higher rate, I will sell to your competitor but not to you." In such an environment, any market power vis-a-vis video-programming services disappears. If discounts continue to appear, they must reflect efficiencies — not the exercise of market power. These efficiencies should not lightly be sacrificed.

Any offsetting benefits would be entirely speculative. Competition to cable operators has come from firms that are major MVPDs in their own right. For example, the two DBS providers are each top 10 MVPDs. *See Seventh Competition Report* Table C-3. Based on their subscriber count, these firms themselves are entitled to substantial programming discounts. Consumers therefore should not be denied these efficiencies on the theory that impeding discounts might spur competition from "overbuild startups." *FNPRM* ¶ 43. In any event, such startups would not be helped by a subscriber limit: they would still be smaller than most cable operators. Besides, overbuilders have chosen to challenge large as well as small MSOs.[38] This negates any notion that discounts make a significant difference in overbuilders' entry choices. *See* Joskow & McLaughlin 26.

Even if programming discounts posed a non-conjectural problem, it is unclear how the Commission could rationally translate the concern into a percentage limit. Although the Commission's foreclosure theory has many problems of its own, at least it can be (loosely) anchored to a percentage limit — on the (mistaken) theory that new video-programming services need unimpeded access to a minimum number of subscribers. It is entirely unclear how this could be done in the case of a discount-based theory. Even assuming that excessive discounts pose a non-conjectural problem, it is simply impossible to determine in a logically comprehensible way at what percentage point the problem would begin.

2. The *FNPRM* Is Wrong in Suggesting That MVPDs Will Have a Lesser Incentive To Innovate When Concentration Increases.

The *FNPRM* further suggests that, in the presence of high levels of concentration, cable operators "might experience diminished incentive to innovate, either through upgrades and improvements in their plant and their customer service, or their program offerings." *FNPRM* ¶ 31. The facts are directly to the contrary. Innovations of these kinds have traditionally come from larger MSOs, not smaller ones. Thus, for example, Time Warner Cable has long been in

[38]For example, RCN competes with AT&T Broadband in Boston, Time Warner Cable and Cablevision in New York City, and Comcast in Washington, D.C. *See* RCN Press Release, *RCN Launches Service in Two New Markets for Resilink, Its Unique Bundled Communications Product* (July 16, 2001); RCN Press Release, *RCN Expands Its Strong Presence in the New York Market with Moves into Brooklyn and the Bronx* (Aug. 3, 2000); Starpower, *Availability*, http://www.starpower.net/availability/dc.html.

the forefront of innovative developments like local news channels, hybrid-fiber-coax architecture, cable-modem service, video-on-demand, and IP telephony.[39] To suggest that crimping the size of MSOs will spur such developments — at a time when MSOs are attempting to compete with incumbent LECs in providing residential telephone service — has things exactly backwards.

3. The *FNPRM* Is Wrong in Suggesting That a Subscriber Limit Is Necessary To Facilitate "Benchmarking."

The *FNPRM* next suggests that a subscriber limit may be justifiable on the ground that it would make it easier for local franchising authorities ("LFAs") to engage in so-called "benchmarking": the practice of comparing regulated entities' conduct. *See FNPRM* ¶¶ 32-34. But there are three serious problems with this theory.

First, the statute empowers the Commission to create a subscriber limit only "to enhance effective competition." 47 U.S.C. § 533(f)(1). The statute does not empower the Commission to enhance effective regulation. *See also FNPRM* ¶ 60 ("The purpose of Section 613(f) is 'to enhance effective competition,' and the legislative history . . . indicates a preference for competition over regulation."). Moreover, each of the specific provisions in Section

[39]*See, e.g.*, Arthur Cole, *The 2001 Service in Technology Award: Time Warner Leads on Three Fronts*, Communications Technology (May 2001), available at http://www.cabletoday .com/ct2/archives/0501/066_timewarner.htm ("It's not a secret that when it comes to pushing the envelope, Time Warner Cable is the leader of the pack. . . . The technology that Time Warner spearheaded is, in fact, becoming the de facto standard for the entire cable industry: hybrid fiber/coax (HFC) plants; Data Over Cable Service Interface Specification 1.1 (DOCSIS 1.1) and PacketCable for Internet protocol (IP) telephony and routed Moving Picture Experts Group-2 (MPEG-2) packets for video-on-demand (VOD). . . . To date, Time Warner has ushered in a number of trials covering three crucial technologies: VOD, VoIP, and multiple Internet service providers (ISPs).").

533(f)(2)(A) and (B) directs the Commission's attention to issues of effective *competition* — not issues of effective *regulation*. Thus, the statute simply cannot be read to authorize the imposition of a subscriber limit on benchmarking concerns — no more than the statute permits imposition of a subscriber limit on diversity grounds. *See Time Warner II*, 240 F.3d at 1136 (the statute "sharply confines the authority to regulate solely in the interest of diversity").

Second, a subscriber limit is simply unnecessary to facilitate benchmarking. In the many rounds of comments that have preceded this one, no LFA has ever filed comments suggesting that its ability to engage in benchmarking was in need of improvement, let alone that this aim could be accomplished by imposing a subscriber limit.[40] That is not surprising: a provision added by the 1992 Cable Act states that, in regulating cable operators, LFAs may not consider "the mix or quality of cable services or other services provided." 47 U.S.C. § 546(c)(1)(B). Thus, LFAs are by law prohibited from engaging in almost all forms of benchmarking. In light of that fact, it is hard to understand how the promotion of benchmarking could even constitute an "important" governmental interest for purposes of First Amendment scrutiny.[41]

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[40]*See Home Box Office, Inc. v. FCC*, 567 F.2d 9, 37 (D.C. Cir.) (per curiam) ("The Commission assures us that siphoning is 'real, not imagined.' We find little comfort in this assurance, however, because the Commission has not directed our attention to any comments in a voluminous record which would support its statement.") (citation omitted), *cert. denied*, 434 U.S. 829 (1977).

[41]*See, e.g., Quincy Cable TV, Inc. v. FCC*, 768 F.2d 1434, 1455 (D.C. Cir. 1985) ("If, in fact, the FCC has repudiated the . . . assumptions that underlie the . . . rules, the suggestion that they serve an important governmental interest (or any interest at all) would be wholly unconvincing."), *cert. denied*, 476 U.S. 1169 (1986); *HBO*, 567 F.2d at 40 (Commission may not rely on interest to uphold one measure where other measure directly undercuts the same interest); *Chesapeake & Potomac Tel. Co. v. United States*, 830 F. Supp. 909, 929-32 (E.D. Va. 1993) (same), *aff'd*, 42 F.3d 181 (4th Cir. 1994), *vacated and*

Finally, even if the benchmarking concern were at all legitimate, it is unclear how it could logically give rise to a percentage cap — say nothing of a 30-percent cap. For an LFA to be able to engage in benchmarking, it would need only a few points of comparison. Thus, even if the industry were dominated by a single MVPD, LFAs should still be able to engage in ample benchmarking so long as some systems were operated by a few other MVPDs.

4. Any Suggestion That Concentration Results in Diminished Programming Variety Is Wrong.

Finally, the *FNPRM* asks whether "a monopoly MVPD would provide fewer choices among similar types of programming and charge higher prices for that programming than competitive MVPDs." *FNPRM* ¶ 35. Even assuming that were so, it is unclear how a subscriber limit would improve matters. A subscriber limit does nothing to promote competition: limiting the size of MSOs does not by itself subject them to more competition. Meanwhile, a subscriber limit would be counterproductive: the evidence shows that, compared to smaller MSOs, large MSOs provide more programming at a lower price. *See supra*, p.18.

II. THE COMMISSION SHOULD NOT REINSTATE ANY CHANNEL-OCCUPANCY LIMIT.

In *Time Warner II*, the D.C. Circuit found fault with the Commission's channel-occupancy limit in two respects. *First*, the court of appeals held that the Commission had made "no effort to link [its 40-percent channel-occupancy limit] to the benefits and detriments depicted." 240 F.3d at 1138. As the court concluded, "the FCC seems to have plucked the 40% limit out of thin air." *Id.* at 1137. *Second*, the court of appeals faulted the Commission

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remanded on other grounds, 516 U.S. 415 (1996) (per curiam).

for its "refusal to exclude from the vertical limit cable operators that are subject to effective competition." *Id.* at 1138. As the court pointed out, Time Warner "argue[d], quite plausibly, that exposure to competition will have an impact on a cable company's *ability* to indulge in favoritism for in-house productions." *Id.* The court held that the Commission had failed to provide a coherent response to this argument. The *FNPRM* invites comment on each of these points. *See FNPRM* ¶¶ 74-84.

The basic rationale underlying the channel-occupancy limit appears to be a prophylactic measure aimed at discrimination against unaffiliated video-programming services. The notion appears to be that, to facilitate entry, a certain number of channels should be set aside for unaffiliated video-programming services. *See id.* ¶ 81 (citing concerns about "market foreclosure"). For all the reasons set forth above in regard to subscriber-limit issues, there simply is no cause for any foreclosure concerns. Quite apart from the fact that discrimination on the basis of affiliation is already targeted by more specific rules, *see* 47 U.S.C. § 536(a)(3); 47 C.F.R. § 76.1301(c), there simply is no indication that entry by independent video-programming services is in any way impeded. As the Commission itself points out, the number of independent video-programming services has for years been on the rise. *See FNPRM* ¶ 79. Of all national video-programming services, 75 percent are now independent, compared with only 47 percent in 1994. *See id.* Moreover, if entry by independent video-programming services was ever a concern, increased competition from DBS and increased channel capacity eliminate the concern. *See id.* ¶¶ 77-78.[42]

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[42]In addition, the PEG, leased-access, and must-carry provisions further assure that independent video-programming services can obtain cable carriage. *See* 47 U.S.C. §§ 531,

As the Commission itself suggests, the only correct approach under these circumstances is to forgo adopting a channel-occupancy limit. *See id.* ¶ 83. And the statute clearly permits that approach. *See supra*, pp. 9-10 n.6. The statute merely requires the Commission to "conduct a proceeding . . . to prescribe rules and regulations establishing reasonable limits on the number of channels on a cable system that can be occupied by a video programmer in which a cable operator has an attributable interest." 47 U.S.C. § 533(f)(1)(B). The Commission *has* conducted such a proceeding. If it finds that no limit is justified by a non-conjectural problem, "reasonable limits" are no limits at all.[43] Regardless, even if the Commission finds that *some* limits might be justifiable, it still must "link the numerical limits to the benefits and detriments depicted" (*Time Warner II*, 240 F.3d at 1138) — *i.e.*, it must explain how the particular percentage limit chosen is logically related to the non-conjectural problem sought to be remedied. Even at this late date (almost a decade into this proceeding, and after a judicial remand faulting it on this very point), the Commission has not even hinted how it might do that.

If the Commission adopts a channel-occupancy limit, it must create an exception for cable systems subject to effective competition. For the reasons explained above, where a cable operator is subject to effective competition, anticompetitive conduct is self-defeating. *See supra*, pp. 10-13; *see also Time Warner II*, 240 F.3d at 1138-39.

532, 534, 535.

[43]The *FNPRM* also seeks comment "on the possibility of fashioning a 'process' rule rather than a fixed limit (*e.g.*, a rule that would place limits on a cable operator only after a finding that it had unfairly limited or foreclosed access)." *FNPRM* ¶ 84. There is no need for such a "process" rule — it already exists. *See* 47 U.S.C. § 536(a)(3); 47 C.F.R. §§ 76.1300-76.1302.

III. THE COMMISSION SHOULD NOT REINSTATE THE INVALIDATED ATTRIBUTION DECISIONS.

In *Time Warner II*, the D.C. Circuit invalidated two of the Commission's attribution-related decisions. *First*, the court set aside the Commission's decision to repeal the single-majority-shareholder exception[44] — an exception to the usual attribution rules under which a minority stake is not attributed if another single person owns more than 50 percent of the shares. *See* 240 F.3d at 1142-43. As the court pointed out, "[i]n dispatching the exemption . . . , the Commission cited only its concern that a minority shareholder *might* be able to exercise influence even in these circumstances [*i.e.*, where there is a single majority shareholder]." *Id.* at 1143. That concern, the court explained, "would be a basis, if supported by some finding grounded in experience or reason, but the Commission made no finding at all." *Id.* *Second*, the court set aside one of the criteria that a limited partner must satisfy to qualify for an exemption from attribution: that the partner not sell programming to the partnership. As the court held, "the Commission has drawn no connection between the sale of programming and the ability of a limited partner to control programming choices." *Id.* The *FNPRM* invites comment on each of these aspects. *See FNPRM* ¶ 85 n.196; *id.* ¶ 87.

A. The Commission Should Not Repeal the Single-Majority-Shareholder Exception.

The Commission asks whether "a minority shareholder's influence over a corporation that has a single majority shareholder is so limited that the minority shareholder's interest

[44]*See Implementation of the Cable Television Consumer Protection and Competition Act of 1992; Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996; Review of the Commission's Cable Attribution Rules*, Report and Order, 14 FCC Rcd 19014, ¶ 81 (1999) ("*Attribution Order*").

should not be attributable." *Id.* ¶ 90. The question here of course is not whether such a shareholder might exercise some modicum of influence; rather, the question is whether his influence is so small as to be of no concern — just like that of a below-five-percent shareholder. The answer is yes.

Where there is a single majority shareholder, that shareholder can outvote any minority shareholders on any issue.[45] In particular, minority shareholders have no way to supplant management, "a fact that management would bear in mind in deciding to whose exhortations it should pay attention." *Time Warner II*, 240 F.3d at 1140. To be sure, under the corporate laws of most States, management has a fiduciary duty to refrain from benefitting the majority shareholder at the expense of minority shareholders. *See FNPRM* ¶ 90 & n.208. But management has no duty to do minority shareholders special favors. Thus, any attempt by a minority shareholder to exercise influence over management's programming decisions (say, by a minority shareholder suggesting that management add to the system's channel line-up a video-programming service owned by the minority shareholder) will carry no more weight than the advice of an outsider.

The *FNPRM* suggests that, if the single-majority-shareholder exception remains in place, it will be limited by the "equity plus debt" rule, under which any combination of 33 percent of a cable operator's equity and debt is attributed even if it would not be caught by the 5-percent equity rule. *See id.* ¶ 89. But this conclusion as to the interplay of the "equity plus debt" rule

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[45]*See, e.g., Corporate Ownership Reporting and Disclosure by Broadcast Licensees*, Report and Order, 97 F.C.C.2d 997, ¶ 21 (1984) ("[T]he minority interest holders, even acting collaboratively, would be unable to direct the affairs or activities of the licensee on the basis of their shareholdings.").

and the single-majority-shareholder exception has no basis in logic. The rationale behind the single-majority-shareholder exception is that, where there is a single majority shareholder, a minority ownership stake will not unduly influence programming decisions — even if it would be attributable in the absence of a single majority shareholder. That rationale applies no less to the "equity plus debt" rule than to the 5-percent attribution rule. Thus, the single-majority-shareholder exception should be an exception to the "equity plus debt" rule as well as the 5-percent attribution rule.

Alternatively, if this interpretation of the "equity plus debt" rule does prevail, it would be even more difficult for the Commission to justify eliminating the single-majority-shareholder exception: the only minority interests that might be exempted from attribution under the single-majority-shareholder exception would be interests small enough that they do not trigger the "equity plus debt" rule. Even if there were some reason to believe that a minority owner with a significant interest (say, 40 percent) in a company with a single majority owner might have the ability to influence programming decisions, that influence would be attributed under the "equity plus debt" rule; there is no need to capture smaller interests by eliminating the single-majority-shareholder exception.

B. The Commission Should Not Reinstate the "No-Sale Criterion."

Whereas the Commission should reinstate the single-majority-shareholder exception, it should not reinstate the "no-sale criterion," which holds that, for an interest in a limited partnership to be non-attributable, a limited partner must certify that it does not sell video-programming services to the partnership. *See Attribution Order* ¶¶ 64, 106. This criterion continues to lack any rational basis.

What should matter is whether the limited partner can exercise influence over the limited partnership's video-programming decisions *qua* partner — not *qua* programmer.[46] The answer is no. Simply selling programming to a partnership no more increases a partner's influence than selling coffee cups. And, if the Commission is concerned that contacts in the course of programming sales (say, demands by a programmer that a cable operator carry sister services) might cloak influence exercised *qua* partner, that concern is unfounded: any such contacts would be off limits for a different reason. To become insulated, a limited partner must also certify that it does not "communicate with the licensee or general partners on matters pertaining to the day-to-day operations of its video-programming business." *Id.* ¶ 64.

The *FNPRM* suggests that *Twentieth Holdings Corp.*, Decision, 4 FCC Rcd 4052 (1989), supports the notion that the sale of programming necessarily spells partnership influence. *See FNPRM* ¶¶ 94, 96, 97. But *Twentieth Holdings* involved the sale of network programming to a broadcast station. *See* 4 FCC Rcd 4052, ¶ 13. The broadcast network-affiliate relationship, which involves the provision of a large proportion of the affiliate's prime-time programming, is necessarily more comprehensive than the relationship between a video-programming service and a cable operator. It is simply wrong to liken the relationship between, say, the Cartoon Network and a cable operator on which it occupies one out of 90 channels to the relationship between, say, NBC and a local NBC affiliate. Whatever merit

[46]*See Time Warner II*, 240 F.3d at 1143-44 ("[A] programmer might secure contract terms giving it some control over a partnership's programming choices, but, given the independent criterion barring even communications on the video-programming business, exercise of that power would seem to be barred. *Even if it weren't, the bargaining opportunity would depend on the desirability of the partner's programming, not on its status as a partner.*") (emphasis added in part; citation omitted).

there might be to this restriction in the broadcast context, it is clear that any such concerns are inapplicable with respect to cable operators.

Conclusion

For the reasons set forth above, the Commission should not reinstate a subscriber limit, should not reinstate a channel-occupancy limit, should not repeal the single-majority-shareholder exception, and should not reinstate the no-sale criterion.

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